FISCAL NOTE

HB 3173 - SB 3097

March 22, 2002

SUMMARY OF BILL:

- *Creates the Revenue Act of 2002.*
- Exempts from state and local sales tax, effective October 1, 2002: food and food ingredients for human consumption; clothing and protective equipment; and non-prescription drugs. Provides a definition for food, clothing and protective equipment, and non-prescription drugs. Items that would remain subject to the sales tax are candy, dietary supplements, prepared food, alcohol products, tobacco products, clothing accessories or equipment and sport or recreational equipment.
- Holds local governments harmless for the exemption of food and food products for human consumption; clothing and protective equipment; and non-prescription drugs.
- Reduces the state sales tax rate from 6% to 4.25%, effective October 1, 2002.
- Requires no later than July 1, 2003 there shall be included in the Tennessee Basic Education Program an amount of money sufficient to provide for the additional needs of students identified as being at risk of educational failure to the extent that those needs cannot be met through the regular educational program.
  - Requires such additional funding to be treated as a classroom component under TCA 49-3-354.
  - Requires the Commissioner of Revenue, if state funds available for distribution under this provision are insufficient to meet the local public school systems' entitlements, to apply a pro rata reduction to the amount for which each system is eligible under this provision.
  - Until such time as this provision is fully funded, such pro rata reduction shall be applied separately from the pro rata reduction provided in TCA 49-3-354 and shall not affect the remainder of the basic education program formula.
  - Upon full funding of this provision and thereafter, the at-risk component shall be treated like all other components of the formula and shall not be subject to a separate pro rata reduction.
  - For purposes of implementing this section, educational failure shall be either failure to meet the requirements for promotion to the next grade level; or failure to meet the graduation requirements established in TCA 49-6-6001 and to obtain a high school diploma.
  - Requires the state board of education, through the review committee process established in TCA 49-1-302(a)(4) to develop and recommend to the general assembly no later than January 1, 2003, a method for distributing the funding necessary to implement the requirements of this section. Further requires the state funding board to develop guidelines for applying the definition established herein to determine the distribution of such funds. Among the factors that may be considered in such guidelines are poverty and failure to master English as a second language.
  - Authorizes any local education agency (LEA) to budget and expend the funds generated by this provision in any otherwise lawful manner so long as the LEA

meets the accountability requirements established pursuant to TCA 49-1-601. No further restrictions shall be applied to the use of these funds.

- Modifies the apportionment formula for sales tax revenue.
- Modifies the Local Option Revenue Act of 1963.
- Creates the *Local Government Sales Tax Act of 2002* which:
  - Requires each county by resolution of its county legislative body and incorporated city or town to levy a local sales tax at the rate of 2.75% effective October 1, 2002.
    - The local sales tax of 2.75% would apply to the full amount of the purchase price on all items except those outlined below:
      - On industrial and farm machinery as defined in TCA 67-6-102, and on water sold to or used by manufacturers that is taxed at the state rate of 1%, the local tax rate will be 0.5%
      - Sales of tangible personal property to common carriers for use outside this state subject to the reduced rate provided in TCA Title 67, Chapter 6, Part 2, the local tax rate would be 1.5%.
      - Allows dealers with no location in the state to choose to pay, in lieu of tax otherwise provided by this part, local tax at the rate of 2.25% of the sales price on all sales made in the state.
      - Interstate telecommunications services, which are subject to the state tax, would be assessed a 1.5% local sales tax, provided, that interstate telecommunication services sold to businesses are exempt from local sales tax.
      - Continues the current law of allowing the department of revenue to keep 1.125% to defray the cost of administration of the local sales tax.
      - Requires any new revenue generated by the Local Government Sales Tax Act of 2002 to be deposited in the dedicated education fund for each local education agency provided in TCA 49-3-352, according to the procedure and formula established in TCA 49-1-302 and 49-3-351. For purposes of this section, defines new revenue as annual revenue generated under the Local Government Sales Tax Act of 2002 for the fiscal year beginning July 1, 2003, and in each subsequent year, that exceeds the total revenue generated under the 1963 Local Option Revenue Act in the fiscal year ending June 30, 2002.
      - Maintains the current distribution formula for local government sales tax revenue under the base amount of revenue generated by the 1963 Local Option Revenue Act in the fiscal year ending June 30, 2002.
      - Prohibits any county or municipality from supplanting local funds with revenue provided to such county or municipal government under the Revenue Act of 2002.
- Repeals the Hall Income Tax, effective July 1, 2002 for tax years beginning on or after January 1, 2002 as follows:
  - Modifies the apportionment formula for the state-shared portion of the tax.
  - Holds local governments harmless for the change initially.
  - Decreases the hold harmless allocation provision 10% per year, using FY 00-01 as the base year, until the hold harmless amount is phased out in FY 12-13.

- <u>Implements "The Tennessee Income Tax Law of 2002".</u>
  - Enacts a broad-based income tax with rates ranging from 3.5% to 6%.
    - <u>Exemptions</u>

Single or Married Filing Separate	$18,000
Head of Household	$26,400

Married Filing Jointly	$36,000
Per Dependent (not including taxpayer)	$ 2,500

- The tax applies to Adjusted Gross Income on a taxpayer's federal income tax return. Interest earned on obligations issued by other state and non-Tennessee political subdivisions that are not federally taxable will be added to Adjusted Gross Income, as will certain lump sum distributions included in gross income for federal tax purposes.
- A deduction from Adjusted Gross Income is allowed for 50% of any long-term capital gain.
- Deductions also occur for amounts not taxable by states under federal law or income not taxable under Tennessee law.
- A Tennessee resident will get a credit for income taxes paid on the same income in another state just as a non-resident earning income in Tennessee will get a credit in their state of residency.
- Provides any person exempt from federal income tax by reason of its purposes or activities shall be exempt from state income tax, but is not exempt from the reporting and withholding requirement provisions of the bill.
- For the tax year beginning on or after January 1, 2002, the tax rate will be one-half the full rate. In all succeeding tax y ears, the rate of tax shall be the full rate outlined in provisions of the bill.

- Provides a credit of the Professional Privilege Tax against state income tax liability.
- Requires employers, no later than 30 days after the effective date of this act, who maintain an office or transacts business within this state and pays any wages to a resident or nonresident individual to register with the Department of Revenue.
- Allows any person required to register for withholding to bring an action for declaratory judgment concerning the constitutionality or validity of the income tax in the Chancery Court of Davidson County. Requires the appeal of any such action to be taken directly to the Supreme Court.
- Prohibits appropriations for general expenditures from state tax revenues to exceed 6% of the state's economy.
  - Defines *general expenditures* as appropriations of amounts collected from state taxes identified by TCA 9-4-5202(b), to the debt service fund, the capital projects fund, the highway fund, the education trust fund and the general fund.
  - Defines *state's economy* as personal income as provided in TCA 9-4-5201(b).
- Outlines a procedure, which applies if the revenues exceed the maximum 6% level.

ESTIMATED FISCAL IMPACT:

Increase State Revenues - Net Impact $563,255,922 FY 02-03
$725,710,923 FY 03-04

Increase State Expenditures - Exceeds $30,000,000 Recurring
Exceeds $25,000,000 One-Time

Increase Local Govt. Revenues - $214,900,000 FY 02-03

For information purposes, the estimated increase in local government revenues in FY 02-03 results from local governments being allowed to retain the increased revenue collected October 1, 2002 through June 30, 2003 which results from raising the local option sales tax to 2.75% and removing the single article cap. Beginning with fiscal year 03-04, this increase will be deposited into the dedicated education fund.

CERTIFICATION:

This is to duly certify that the information contained herein is true and correct to the best of my knowledge.

James A. Davenport, Executive Director